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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the

Federal Communications Commission
Washington, D.C.

In the Matter of	)	
	)	
GTE Corporation and Bell Atlantic	)	CC Docket No. 98-184
Corporation's Proposed Transfer	)	
of Control of GTE's Licenses and	)	
Authorizations	)	

Comments

of

Consumers Union

and

The Consumer Federation of America

November 23, 1998

Consumers Union[1] (CU) and Consumer Federation of America[2] (CFA) believe that the Bell Atlantic/GTE merger is contrary to the public interest and should be blocked by the Commission. This merger suffers from approximately the same shortcomings as we pointed out in our comments on the SBC/Ameritech merger (see Comments of CFA and CU in CC Dkt. No. 98-141, which we incorporate by reference in this proceeding): with virtually no competition for residential local phone service developing, this merger would result in excessive horizontal concentration through Bell Atlantic/GTE's control of about one-third of local telephone access lines in the country.

Since both merging parties have failed to open their local monopolies to broadbased competition, this merger would make it virtually impossible for new market entrants to compete in the residential market against Bell Atlantic/GTE from the mid-Atlantic region through New England. As a result, even if Bell Atlantic/GTE complies with the requirements of the 1996 Telecommunications Act, this merger is inconsistent with that law's goals of promoting increased local telephone competition and broadbased competition for residential local phone service. This merger is therefore not in the public's interest and is inconsistent with the public interest standards applied by the Commission in previous license transfer applications of this kind (see attached testimony of Consumers Union before the Senate Judiciary Committee's Subcommittee on Antitrust, Business Rights and Competition).

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[1] Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about good, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of *Consumer Reports*, its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, *Consumer Reports* with approximately 4.5 million paid circulation, regularly, carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

[2] Consumer Federation of America is a non-profit consumer advocacy organization representing more than 250 local, state and national consumer groups with a combined membership of more than 50 million Americans.

Respectfully submitted,

CONSUMERS UNION
Gene Kimmelman
Co-Director
1666 Connecticut Avenue, NW
Suite 310
Washington, DC 20009

CONSUMER FEDERATION OF AMERICA
Dr. Mark Cooper
Research Director
1424 16th Street, NW
Suite 604
Washington, DC 20036

Consumers Union

Publisher of Consumer Reports

ATTACHMENT

Testimony of

GENE KIMMELMAN

Co-Director
Washington Office
Consumers Union

before the

Senate Judiciary Committee's

Subcommittee on Antitrust, Business Rights and Competition

on

Consolidation in the Telecommunications Industry

September 15, 1998

INTRODUCTION

Day by day, it becomes more and more obvious that the Telecommunications Act of 1996[1] (The 1996 Act) will not deliver on its promise of broad-based competition and lower telephone prices for most consumers. With telephone monopolies continuing to merge rather than compete, and new charges constantly appearing on consumers' phone bills, Consumers Union[2] believes it is time for antitrust officials to redouble their efforts, and for Congress to revisit this misfiring law.

THE TELECOM ACT: A FAILURE

The problem with this law is obvious: Relying on industry promises of competition despite inadequate market evidence to support such claims, Congress and the Clinton Administration excessively deregulated telecommunications markets. And naively assuming that competition is inevitable, even in markets where competition has never existed, policymakers prematurely relaxed ownership limitations and price regulation. Ironically, these mistakes are likely to produce the opposite of what Congress and President Clinton intended: higher, rather than lower prices and a slow-down, rather than acceleration in competitive market forces.

As pointed out by the Wall Street Journal, Washington Post, *and* USA TODAY:

> Two years ago, the federal government enacted a law designed to crack local telephone monopolies and bring consumers the benefits of competition. By sweeping away decades of regulation, Washington thought it was paving the way for a free-for-all among the Baby Bells, long-distance carriers, cable operators and other telecommunications providers. Instead, the urge to merge has overwhelmed the compulsion to compete. Most people are still waiting for lower phone rates and better service, while the nation's telephone giants seem intent on vying to see which one can become the biggest the fastest.[3]

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[1] Public Law 104-104, 110 Stat. 56 (1996)

[2] Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about good, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of *Consumer Reports*, its other publications and from noncommercial contributions, grants and fees. In addition to reports on consumers Union's own product testing, *Consumer Reports* with approximately 4.5 million paid circulation, regularly, carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

[3] Bryan Gruley, John Simons and John R. Wilke, "Is This Really What Congress Had in Mind With The Telecom Act?" Wall Street Journal, May 12, 1998

> In rewriting the nation's telecommunications law three years ago, Congress envisioned a competitive free-for-all in which long-distance companies and local telephone companies, cable operators and even Internet providers would invade one another's businesses. But in the years since, much of this new competition has bogged down in technical difficulties and regulatory skirmishing-leaving consumers little to show for the new law in the way of lower prices, new services or greater convenience.[4]

> Local Bells, rather than opening their markets to competitors have successfully sued to protect them. Result: After two years, local competitors serve a bare 1% of the Bells' 178 million customers. AT&T spent $5 billion attempting to get in and couldn't make a dent. Cable companies have mounted no serious threat... And proposed mergers and buyouts in other sectors indicate less an interest in head-to-head competition than establishing or preserving monopolies elsewhere in the telecom universe.[5]

CONSOLIDATION

Since passage of the 1996 Act, the eight large local telephone monopolies – seven Bell companies and GTE – have moved very slowly to comply with the law's market-opening requirements and have instead focused on consolidation of their monopolies in local markets. If the pending mergers of SBC with Ameritech and Bell Atlantic with GTE are approved, these eight monopolies will have consolidated into four companies, two of them becoming mega-regional firms that each control about one-third of the nation's phone lines (See Appendix A at Sec. II A).

By extending the advantages of an incumbent monopoly – linking already-built massive networks of telephone lines connecting about one-third of the country, plus the customer relationships, good-will, name recognition and other financial benefits that flow from their existing monopolies – Bell Atlantic and SBC could make it virtually impossible for potential competitors to bring adequate choice of local phone service to consumers in most communities. Even if these companies comply with the market-opening requirements of the 1996 Act, their stranglehold over about one-third of the assets necessary to provide local service and connect long distance calls (i.e., local "loops" connecting telephone users to the phone network) is likely to thwart the development of effective competition in these markets (See Appendix A at Sec. I B).

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[4] Steven Pearlstein, "Phone Companies Eschew Price Wars in Favor of Mergers," The Washington Post, May 12, 1998

[5] Editorial, "Consumers Still On Hold For Benefits Of Competition," USA Today, May 15, 1998

Consumers Union has therefore asked the Department of Justice and Federal Communications Commission (FCC) to block the SBC/Ameritech and Bell Atlantic/GTE mergers, as violations of the antitrust law's limitations on horizontal concentration and the Communications Act's "public interest" standard for promoting competition[6] (See Appendix A for the detailed antitrust problems). Even as these companies claim their mergers will enhance their ability to compete in new markets – promises that have the same ring as those made prior to enactment of the 1996 Act, and then made again to justify previous mergers with Pacific Telesis and NYNEX – they cannot explain how larger local telephone monopolies make it easier for competitors to enter their markets or for consumers to receive more choice and lower prices for telecommunications services.

Unfortunately for consumers, the proposed merger between AT&T and cable giant Tele-Communications Inc. (TCI) is extremely unlikely to counteract the effects of local telephone company consolidation. While many of the architects of the 1996 Act hoped that the cable wire would ultimately become a competitive alternative to the local telephone wire, the cost of making cable competitive has always been prohibitive. Although AT&T claims that it some day hopes to use TCI's cable wires to offer local phone service, even an enormous company like AT&T cannot disregard the economic realities of this undertaking:

> ...in recent days, as executives of AT&T and Tele-Communications Inc. have scrambled to sell Wall Street and the American consumer on the wisdom of their ambitious $31.8 billion merger, one fact has become clear: The technology will tread a costly path on its way from the laboratory into the home.
>
> In addition to the $1.8 billion TCI will spend to upgrade its one-way cable network to a two-way service capable of carrying digital video and sound to its 10.5 million customers, AT&T will need to persuade customers to buy advanced set-top boxes that have connectors for video, computer and telephone, and it will have to install a new generation of advanced Internet routers capable of offering clear voice quality, at its own expense.
>
> So, beyond that first $1.8 billion, the final cost for the entire project could run another $10 billion or more based on an initial per-customer cost of $750."[7]

A recent description of what AT&T needs to do to upgrade TCI's D.C. cable system vividly illustrates the problem of using cable wires to provide telephone service:

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[6] In the Application of NYNEX Corp. and Bell Atlantic Corp. for Consent to Transfer Control of NYNEX Corp. and its Subsidiaries, Before the FCC, File No. NSD-L-96-10, Adopted Aug. 14, 1997, at 6-8

[7] John Markoff, "In AT&T-TCI Deal, Cost and Logistical Problems," New York Times, July 2, 1998

In Georgetown and other parts of the District, the underground conduit is too crowded to add fiber, according to District Cablevision officials and technicians at Bell Atlantic, which had the contract to install the original system. Making room by pulling out the existing copper wire is not practical. Instead, AT&T would have to negotiate new rights-of-way and dig up streets or find new space on telephone poles.

"It's going to be an expensive upgrade to do this one," said Robert L. Johnson, chief executive of Black Entertainment Television and part of a local group of investors that owns the 25 percent of District Cablevision that TCI does not own.

* * *

Look at District Cablevision today, and you see in microcosm why investors across the country are skeptical about AT&T's Big Idea: buy Tele-Communications Inc., ... and upgrade its networks to carry video, high-speed Internet and phone service into millions of homes....

While the District's system is an extreme case, many other systems in the TCI stable also would need major work to reach AT&T's vision....

Investors who know TCI's history know that in 1994, Bell Atlantic Corp. backed away from a merger deal with the cable giant, saying it would be too expensive to upgrade the TCI system for two-way Internet, video and phone service.

In a 1996 interview with The Washington Post, Bell Atlantic Chairman Raymond Smith said he learned almost too late that TCI's network was more "shoddily, haphazardly" constructed than TCI Chairman John C. Malone led him to believe.

"When we started serious due-diligence [studies] on their plant, we were shocked at what we found," Smith said. "It was done in the most economical short-term way, but the longer that plant would stay up the more raggedy it got, and the more impossible it was to deal with that."[8]

So it appears that the AT&T/TCI deal has more to do with AT&T becoming the nation's largest cable monopolist than becoming a player in the local telephone market. With cable rates rising about 8 percent per year, three to four times faster than inflation

[8] Mike Mills, "AT&T's Headache: Upgrading TCI cable Systems," Washington Post, July 11, 1998

since enactment of the 1996 Act,[9] the TCI deal would allow AT&T to make more money as a price-gouging cable monopolist than as a local telephone competitor: "... the cable franchises will remain monopolies. 'One of the secrets of this whole deal,' he [Paul Kagan] said, 'is that AT&T is going to make a bunch of money offering traditional cable television.'"[10]

PRICES RISING

Amidst all of the competitive failures of the 1996 Act, it is not surprising that consumers are facing more and more price increases. Local phone rates are up as much as 20 percent in a number of states,[11] and most local phone companies have attempted to double local rates in one manner or another.[12] In-state long distance prices have been rising faster than inflation and interstate long distance prices are beginning to go up.[13]

Most surprisingly, consumers are being hit with substantial new long distance price hikes from "line-item charges" that appear to reflect a lack of competitiveness for the bottom half of the consumer long distance market. Based on data gathered from the major long distance companies and the FCC, it appears that during 1998, regulatory pricing changes, including new universal service fees, have resulted in net cost reductions of about $1.8 billion for the long distance industry. However during this time period, the vast majority of consumers who make less than $30 per month in long distance calls have received virtually no per-minute rate reductions in the major long distance calling plans offered by AT&T, MCI and Sprint.

In addition, beginning last spring, these companies began charging "federal access charges" (MCI at $1.07/mo., AT&T at 95 cents/mo. and Sprint at 80 cents/mo.) and then new "universal service charges" in July (AT&T at 93 cents/mo., MCI at 5 percent of the long distance bill and Sprint at 4.5 percent of the long distance bill). While these new universal service fees were supposedly only a restructuring of existing charges – eliminating previously implicit subsidies in per-minute long distance charges by creating an explicit line-item charge – consumers have not received offsetting rate reductions since these new charges were added to their bills. And the long distance companies indicate that, as the FCC continues to restructure pricing next year, line-item charges will continue to rise.

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[9] Source: Bureau of Labor Statistics (BLS) Cable Consumer Price Index

[10] Markoff, op.cit.

[11] Steven Rosenbush, "Phone Rates Rising," *USA Today*, April 29, 1998

[12] Mike Mills, "Florida Seeks Higher Rates to Expand Market," and "Phone Firms Seek Higher Local Rates," *The Washington Post*, March 8, 1998 and May 7, 1996

[13] Source: BLS telephone price indexes

If the consumer long distance market were truly competitive, it is hard to imagine how billions of dollars in long distance company savings could translate into rate increases for the vast majority of consumers from all the major carriers. Obviously, significant portions of this market are not competitive and the FCC has done nothing to ensure that consumers receive the savings they deserve. Consumers Union estimates that the long distance companies have failed to pass through as much as $1 billion in consumers savings this year, and this figure could rise to $3 billion in 1999.

THE SOLUTION

Clearly, more aggressive regulatory and antitrust intervention is needed at this point in time to prevent monopolistic pricing and market consolidation from continuing. However, it is also time for Congress to face the fact that the 1996 Act is an abysmal failure which requires immediate restructuring to reflect the ongoing monopolistic problems in telecommunications and cable markets.

Congress must clamp down on price gouging in cable and telecommunications markets (both local and long distance) that are not subject to effective competition, and must give regulators and antitrust officials more tools designed to promote competition and block consolidation. S. 2207, the "Antitrust Improvements Act of 1998," introduced by Sen. Leahy, is a good first step in beginning to address the problems with the 1996 Act.

CONCLUSION

Only by blocking the consolidation of local telephone monopolies and doing more to promote the development of competition, will it be possible for Congress to get back on track delivering the promises originally outlined in the Telecommunications Act of 1996. And only by directing regulators to block monopolistic pricing practices in the cable, local telephone and long distance markets will Congress be able to protect consumers from rising cable and telephone bills. As *USA TODAY* pointed out in a recent editorial: "Consolidation today, competition tomorrow could put off forever the services consumers should have gotten yesterday." [14]

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[14] Editorial, "Consumers Still On Hold For Benefits Of Competition," *USA TODAY*, May 15, 1998

APPENDIX A

THE IMPACT OF TELEPHONE COMPANY MEGAMERGERS ON THE PROSPECTS FOR COMPETITION IN LOCAL MARKETS

Prepared for

THE CONSUMER FEDERATION OF AMERICA

And

CONSUMERS UNION

By

DR. MARK N. COOPER
DIRECTOR OF RESEARCH
CONSUMER EDERATION OF AMERICA

September 15, 1998

I. THE OVERALL IMPACT OF THE MERGERS

A. THE ISSUE BEFORE REGULATORS AND POLICYMAKERS

Evaluation of the proposed mergers between huge local exchange companies must take into account the history of merger policy and activity since the passage of the Telecommunications Act of 1996 (the 1996 Act). In this context, the analysis of industry structure can be posed as two interrelated questions that must be answered. First, are these mergers sufficiently different from earlier telecommunications mergers to require them to be stopped, when others have been approved?

The Consumer Federation of America (CFA) and Consumers Union (CU) believe that the SBC/Ameritech (SBC/AIT) merger and the GTE/Bell Atlantic merger (GTE/BA) are different and should not be allowed to close.15 The differences are

- the order of magnitude of the impact on the national market structure
- the unique regional problem that these mergers pose.
- the continuing monopoly in local markets, and
- the disappointing experience with the introduction of competition.

The second question emerges immediately from the first. If these companies already have a monopoly at the local level, what difference does it make if they gain regional domination or that the national market devolves into a very tight national oligopoly made up of essentially two, 55 million line companies and a number of smaller companies?

We believe that it makes a big difference.

- The greater the market power at the regional and national level the less the likelihood that competitors will break through in the local market.
- The greater the market power at the regional and national level the greater the likelihood that market power will be extended into related industries.

15 CFA/CU vigorously opposed the Bell Atlantic – NYNEX merger (see "Direct Testimony of Dr. Mark N. Cooper on Behalf of New York Citizens Utility Board, The Consumer Federation of America, The American Association of Retired Persons, and Citizen Action of New York," before the State of New York Public Service Commission, Case No. 96-C-0603 and 96-C-0599, November 25, 1996.

These mergers would result in a market structure that is simply too concentrated to support effective competition. For the purposes of this discussion, we include an analysis of the independent and combined effects of the two megamergers. There are two reasons we discuss both mergers.

First, the nation will be deeply affected by each merger. Second, it is also critical for regulators at the federal and state levels to take a comprehensive view of the emerging structure of the telecommunications industry.[16] The continuation of a deal-by-deal, piecemeal view will allow the industry to slip into a thoroughly anticompetitive structure with no overarching consideration of the cumulative effect of individual deals on the prospect for competition.

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16 The Federal Communications Commission recognized the emerging problem in the piecemeal approval of mergers. In Memorandum Opinion and Order, File No. NSD-L-96-10 (released August 14, 1997). The FCC warned:

> Granting this application subject to conditions does not mean applicants will always be able to propose pro-competitive public interest commitments that will offset potential harm to competition. Nor would these particular conditions necessarily justify approval of another proposed merger for which applicants had not otherwise carried their burden of proof. Different cases will present different facts and competitive circumstances. As competitive concerns increase, it becomes significantly more difficult for applicants to carry their burden to show that the proposed transaction is in the public interest. A merger that in the relevant markets eliminated a competitor with even greater assets and capabilities then Bell Atlantic would present even greater competitive concerns. For some potential mergers, the harm to competition may be so significant that it cannot be offset sufficiently by pro-competitive commitments or efficiencies. In such cases, we would not anticipate the applicants could carry their burden to show the transaction, even with commitments, is pro-competitive and therefore in the public interest.
>
> We also note that we are concerned about the impact of the declining number of large incumbent LECs, on this Commission's ability to carry out properly its responsibilities to ensure just and reasonable rates, to constrain market power in the absence of competition, and to ensure the fair development of competition that can lead to deregulation. During the transition to competition it is critical that the Commission be able effectively to establish and enforce its pro-competitive rules and policies. As diversity among carriers declines, both this Commission and state commissions may lose the ability to compare performance between similar carriers that have made different management or strategic choices. We often rely, for example, on cross-carrier comparisons as strong evidence as to technical feasibility or reasonableness. The Bell Companies, being of similar size, history, and regional concentration have, to date, been useful benchmarks for assessing each other's performance. Reducing the number of Bell Companies makes it easier to coordinate actions among them, and increases the relative weight of each company's actions on average performance. Because we approve this merger with conditions, thereby reducing the number of independently controlled large incumbent LECs, future applicants bear an additional burden in establishing that a proposed merger will, on balance, be pro-competitive and therefore serve the public interest, convenience and necessity.

B. MARKET CONCENTRATION

The size and scope of the mergers would have a dramatic impact on the overall market structure. Each of these mergers exceeds the Department of Justice's Merger Guidelines. Taken together, they absolutely fracture the guidelines. Adding these mergers atop the prior mergers would create an industry structure that must be a source of grave concern to policy makers and regulators.

1. CONCEPTUALIZING THE PROBLEM OF MEASURING MARKET POWER

The issue in market structure analysis is to identify situation in which a small number of firms control a sufficiently large part of the market as to make coordinated or reinforcing activities feasible. Through various implicit and explicit mechanisms, when there are a small number of firms they can reinforce each other's behavior, rather than compete. Identification of exactly where a small number of firms can exercise this power is not a precise science. Generally, however, when the number of significant firms falls into the single digits, there is cause for concern, as the following suggests.

> Where is the line to be drawn between oligopoly and competition? At what number do we draw the line between few and many? In principle, competition applies when the number of competing firms is infinite; at the same time, the textbooks usually say that a market is competitive if the cross effects between firms are negligible. Up to six firms one has oligopoly, and with fifty firms or more of roughly equal size one has competition; however, for sizes in between it may be difficult to say. The answer is not a matter of principle but rather an empirical matter.[17]

The clear danger of a market with a structure equivalent to only six equal sized firms was recognized by the Department of Justice in its Merger Guidelines.[18] These guidelines were defined in terms of the Herfindahl-Hirschman Index (HHI). This measure takes the market share of each firm squares it, sums the result and multiplies by 10,000.

A market with six equal sized firms would have a HHI of 1667. The Department declared any market with an HHI above 1800 to be highly concentrated. Thus, the key threshold is at about the equivalent of six or fewer firms.

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17 J. W. Friedman, Oligopoly Theory (Cambridge: Cambridge University Press, 1983), pp. 8-9.

18 U.S. Department of Justice, Merger Guideline, revised, 1992.

Another way that economists look at a market at this level of concentration is to consider the market share of the largest four firms (4-Firm concentration ratio). In a market with six equal sized firms, the 4-Firm concentration would be 67 percent. The reason that this is considered an oligopoly is that with that small a number of firms controlling that large a market share, their ability to avoid competing with each other is clear.

Shepherd describes this threshold as follows:19

> Tight Oligopoly: The leading four firms combined have 60-100 percent of the market; collusion among them is relatively easy.

While six is a clear danger sign, theoretical and empirical evidence indicates that one must have many more firms than six to be confident that competition will prevail -- perhaps as many as fifty. Reflecting this basic observation, the Department of Justice established a second threshold to identify a moderately concentrated market. This market was defined by an HHI of 1000, which is equivalent to a market made up of 10 equal sized firms. In this market, the 4-Firm concentration ratio would be 40 percent.

Shepherd describes this threshold as follows:

> Loose Oligopoly: The leading four firms, combined, have 40 percent or less of the market; collusion among them to fix prices is virtually impossible.20

Even the moderately concentrated threshold of the Merger Guidelines barely begins to move down the danger zone of concentration from 6 to 50 equal sized firms. For a "commodity" with the importance of telecommunications, certainly this moderately concentrated standard is a more appropriate place to focus in assessing the structure of the market. In other words, in simple economic markets levels of concentration typified by 10 equal sized firms are high enough to raise questions about the competitive behaviors of the firms in the market. Given the nature of the telecommunications industry and the special concern about the free flow of ideas, this is a conservative level of concentration about which to be concerned.

2. THE IMPACT OF THE PENDING MERGERS ON MARKET STRUCTURE

On a national scale, at the time of the passage of the Telecommunications Act of 1996, the industry was just above the level that the Department of Justice defines

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19 W. G. Shepherd, The Economics of Industrial Organization (Englewood Cliffs: Prentice Hall, 1985), p. 4.

20 Shepherd, p. 4.

as moderately concentrated.21 The HHI was about 1200. Thus, by the conceptual definition, there was little likelihood that the firms could affect price, but the level of concentration was sufficient to be a source of some concern.

The mergers that have been approved since the Telecommunications Act of 1996 have increased that concentration by about 300 points. This brings the industry to approximately 1500. This moves it past the mid-point of the range that is considered to be moderately concentrated.

The pending mergers have a much larger impact on the national market. Each of the major mergers that have been proposed would increase the HHI by approximately 500 points. Either of the mergers would drive the concentration into the range of 2000, well into the highly concentrated range. Clearly, these mergers are different than the previous mergers.

Taken together, they would put the market at 2500. At this level of concentration, the industry would be a major source of concern. If these mergers are approved, we will have experienced a remarkable and troubling transformation in the local telecommunications market structure in less that three years. We will have moved from an industry structure whose concentration was roughly equivalent to eight equal-sized competitors, which is generally considered to be effectively competitive, to one whose concentration is roughly equivalent to four equal-sized competitors, which is generally considered to be a tight oligopoly and quite vulnerable to abuse of market power.

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21 For the purposes of this analysis, we use the local exchange and exchange access market as a distinct telecommunications market. There is absolutely no doubt that this is a distinct market. The distinction is deeply embedded in public policy under the Telecommunications Act of 1996, as well as economic reality. The Department of Justice analyzes this as a distinct market in its section 271 evaluations (see Affidavit of Marius Schwartz, Competitive Implications of Bell Operating Company Entry into Long-Distance Telecommunications Service," May 14, 1997). This paper demonstrates why concentration of national and regional ownership of local exchange and exchange access assets matters as a matter of public policy. SBC's claim that it will pursue a national local strategy only serves to prove the point that these local assets should be considered from a national and regional market structure perspective.

II. REGIONAL MONOPOLIES AND MARKET POWER IN NETWORK INDUSTRIES

Although formal market concentration analysis is crucial as the starting point for assessing the impact of mergers, other considerations should enter the deliberation process. Factors such as ease of entry, or alternative regulatory protections can be cited to "soften" the conclusion that these mergers are anticompetitive on the basis of market concentration analysis. At the same time, factors such as regional domination (akin to fortress hubs in the airline industry) or past behavior can be cited "strengthen that conclusion. On balance, the factors arguing that these mergers will be bad for the public far outweigh those that suggest they would be in the public interest.

A. THE FAILURE OF LOCAL COMPETITION

One of the considerations that regulatory authorities can take into account in moving beyond the formulaic calculation of concentration ratios in analyzing mergers is the ease of entry into the industry. If it can be argued that entry barriers are low, even high levels of concentration may not indicate anticompetitive impacts are likely to flow from a merger. Regulators across the nation can find no comfort on this score in reviewing these mergers.

Although the legal barriers to local competition were removed in principle by the 1996 Act, there continue to be numerous administrative, technical and economic barriers to competition. The severe difficulty of introducing local competition under the 1996 Act and the clear pattern of preventing local competition from taking root in which these companies have engaged indicates that ease of entry cannot be counted as a factor that mitigates the conclusion based on the concentration measures. These are steadfast local monopolists who are proposing mergers that would result in a tight oligopoly at the national level.

If past conduct is any indicator of the prospects for local competition, these companies fail that test too. Individually and collectively they have thrown every barrier imaginable in the way of competition.

The Telecom Act's fundamental premise that breaking down legal barriers to market entry would unleash a barrage of facilities-based competition in which cable companies used their plant to attack the local phone market and local phone companies used their networks to attack cable has proven wrong. Nation-wide, facilities-based competitors for local telephone service have taken less than one percent of the business market. Facilities-based competition is virtually non-existent in the residential sector.

Of course, Congress understood that it would take a long time to build competing facilities so it opened less ambitious paths to market entry. Congress demanded that new entrants be allowed to use existing bottleneck facilities at cost-based, nondiscriminatory rates, terms and conditions. These have been thoroughly frustrated by the refusal of the incumbents to cooperate and tied up in courts and in administrative proceedings. The result is that these approaches have failed to break the local telephone monopoly. Even including resale, with the exception of a few major urban areas where competitors have two or three percent of local business customers, incumbents still have a 99 percent market share in the business sector, and almost 100 percent for residential ratepayers.

The threat of entry by alternative technologies has also failed to materialize. In local telephone markets, wireless remains between five and ten times more expensive for the average residential customer. "One-wire" integrated cable-telephone networks have proven too expensive and unworkable.

B. THE REGIONAL DEPLOYMENT AND STRATEGIC USE OF THE MERGED ASSETS

The analysis of national market concentration does not fully reflect the impact of these mergers on market structure. The mergers would create two 60 million-line companies with highly concentrated regional monopolies at the heart of a tight national oligopoly. SCB/AIT would have approximately 40 million lines in the contiguous area from Ohio to Texas. GTE/BA would have approximately 40 million lines in the contiguous area from Maine on the North to North Carolina on the South to Ohio and Indiana on the West. The remaining landline market is only 60 million lines and these are much more scattered around the country (Bell South, US West and the other independents).

This deployment of assets gives the merging companies an immense advantage in the local market. The other companies in the industry lack these two fundamental characteristics. That is, they have virtually no assets deployed to serve local markets. They have virtually no loops and no central office facilities. To the extent that they have telecommunications assets deployed, they are spread around all fifty states. Thus, not only would each of the companies control about one-third of the national market, but also one quarter of the assets they control would be concentrated in a regionally dominant position. The mergers create end-to-end networks that give the incumbents a decided advantage if they are allowed to enter the long distance or other lines of business. The merged companies can capture traffic internally, whereas competitors have much less ability to do so.

This regional domination is an added element of the economies of scale and scope the companies will enjoy. It is quite clear that the merging parties intend to capture economies of scale and scope with this combination of assets. Scale economies will result from sheer size. Scope economies result from the ability to provide end to end service. Competitors cannot match these advantages.

C. THE LOSS OF A LIKELY COMPETITOR

It must also be said that the merger of these two companies denies ratepayers of a potential competitor. Non-incumbent local telephone companies with expertise, assets deployed nearby, centralized functions that could support local competition should have been the most likely candidates to compete with incumbents.

Incumbent local exchange companies have deployed strategic investments -- investments in excess of the needs of its own local service -- which would be easily used to support entry into each other's territory. They have the appropriate expertise and the available resources to fund entry into competitor's service territories. They obviously believe that they can achieve economies of scale by entry, they just prefer to buy more customers rather than compete for them. The services which they sell in their home markets and which could be provided in competitive markets include the full gamut of telecommunications and information services.

Ironically, Bell Atlantic, one of the companies most directly involved in the merger wave in the telecommunications industry, described these unique resources that incumbent local exchange companies possess. Its own statements support the notion that the loss of a local exchange company as a potential competitor is a serious setback for competition. In attempting to convince the Department of Justice that it should be allowed to merge with TCI, Bell Atlantic argued that a local exchange partner was indispensable for competition to develop in local telephone service. 22

22Bell Atlantic's Request for an Expedited Waiver Relating to Out-of-Region Interexchange Services and Satellite Programming Transport, United States of America v. Western Electric Company, Inc., and American Telephone and Telegraph Company, Civil No. 82-0192 (HHG) January 20, 1994. The request consists of six parts, the request itself and five affidavits (Affidavits in Support of Bell Atlantic's Request for an Expedited Waiver Relating to Out-of-Region Interexchange Services and Satellite Programming Transport , January 20, 1994. Individual affidavits include Alfred E. Kahn and William E. Taylor (hereafter Kahn and Taylor); Gary S. Becker (hereafter Becker); Robert W. Crandall (hereafter Crandall); Robert G. Harris (hereafter Harris); and Brian D. Oliver (hereafter Oliver).

> In short, go-it-alone undertakings by telephone and cable companies simply do not begin with adequate technical expertise and other resources to challenge dominant, well-established incumbents. Cable/telco alliances are therefore essential to these companies' effective entry into another's business (Request at 11, emphasis added).

Bell Atlantic claims that without the expertise and resources of a BOC even the nations largest cable operator could not go into the telephone business.

> On their own, cable operators lack the expertise in telephone technology and service that will be a critical factor in any attempt to compete effectively with the incumbent telco. That is why alliances between cable operators and telephone companies from other regions, like the Bell Atlantic/TCI/Liberty merger, are the best opportunity in the short term for real competition against incumbent LECs" (Becker, at 5 emphasis added).

Bell Atlantic has painted a bleak picture of the difficulty of cable entry into the local telephone business. The following is the list of technical and organizational obstacles to cable entry that Bell Atlantic put before the Department of Justice.

> In addition to this fundamental architectural problem, cable systems lack a number of other capabilities for providing local telephone service.
>
> a. Most fundamentally, cable systems lack the sophisticated switching systems necessary to route telephone traffic on a call-by-call basis among subscribers or between subscribers and carriers.
>
> b. Cable systems also lack the specialized billing systems needed to handle multiple services and large volumes of individually metered transactions.
>
> c. The provision of local telephone service also requires specialized operations Support Systems to hand facilities provisioning, administration and maintenance, traffic management, service evaluation, and the planning and engineering associated with switched services. While customers might tolerate loss of television service for several hours or more, they demand virtually fault-free telephone service. *
>
> d. The provision of local telephone services also requires a series of technical and economic arrangements for routing of telephone traffic

between and among local cable systems, the incumbent local service provider, wireless systems and long distance carriers.
e. Finally, cable companies typically do not have the radio engineering skills needed to provide telephone services using wireless technology.

*/ Operating Support Systems normally include extensive record-keeping systems for lines and trunks, automated trouble reporting systems, signal network controls and administration, long-range facilities and switching capacity planning systems, alarm surveillance systems, a variety of equipment tracking and inventory systems, centralized switching and transmission systems, and control and monitoring systems" (Oliver at 4,5,6).

We find it ironic that SBC had to buy Ameritech (or Ameritech had to be bought by SBC) in order to gain an interest in competing in other cities. In fact, SBC should have been particularly keen to attack Ameritech's markets, since Ameritech had actually moved to enter some of SBC's markets, at least on a resale basis.

While it is theoretically and economically correct to say that the nation loses a competitor because SBC and Ameritech are no long available to attack each other's markets and Bell Atlantic and GTE would not be available to compete with each other, it also should be said that the incumbent LECs have shown little stomach for real competition. Since the passage of the Telecommunications Act these companies have not only made it virtually impossible for new entrant to compete within their territories, they have refused to attack the service territories of their sister companies. Only Ameritech had been certified to compete in a number of states. It was, however, restricting itself to resale competition.

The SBC/AIT claim that this is somehow the final ingredient that will finish the recipe for local competition should be taken as the grain of salt that it is. There is no legal, economic, or technical reason why a company must rise to a market share of one-third before it can be moved to compete outside of its service territory. There is no reason why a company which has shown no inclination whatsoever to compete, should be suddenly transformed into a vigorous competitor once it becomes a dominant firm. Quite the opposite is likely, as we have seen in California as a result of the SBC/PACTel merger. The promise of future competition is an elaborate ruse intended to distract regulators from the clearly anticompetitive effects of the merger during the approval process.

Because we are dubious about the commitment of these companies to compete under any circumstances, we believe the major damage to competition comes from the substantial reinforcement to barriers to entry that would result from the merger that were discussed above and the hostility of the new parent company to local competition, which is discussed in the next section.

D. LEVERAGING MARKET POWER INTO OTHER MARKETS?

Because the market power on the supply-side of the point of sale is reinforced by a low elasticity of demand, the ability of incumbent telephone monopolists to leverage their market power is considerable.

This means that consumer resistance to price increases or bundling is limited. The low elasticity of demand for basic network access can also be leveraged to attack other markets. Distribution has become so highly concentrated at the regional and national scale that a successful launch of new services may come to require the implicit consent and support of the major national players. Bundling and packaging of services can be used to foreclose demand. An independent content provider cannot get in front of enough eyeballs or talk to enough computers to make a go of it without access to the dominant systems.

The increasingly large regional telephone monopolies have begun to show how they will leverage this market power. They have begun to try to control the success of upstream entities be leveraging their monopoly at the point of sale and favoring integrated firms. They have tried to do this in their joint marketing arrangement for long distance service in which they give an advantage to one supplier over others. Similarly, in seeking to have their high-speed networks declared not to be common carriage networks, they hope to gain an ability to choose the Internet service providers who will have access to their huge base of subscribers.

Independent content providers, who are not affiliated with the dominant local/regional monopolist, have little ability or incentive to compete on price since they do not have an alternative outlet. They may as well pay the excess to the distribution monopolist and tap into the larger market.

E. ENTRENCHMENT OF MARKET POWER HURTS CONSUMERS

The continuing lack of competition and the concentration and integration in the industry have created perverse pricing policies. Facilities-based competitors in the telephone industry have argued for higher prices, rather than lower, in order to create margins for their new facilities. The use of bottleneck facilities has come at price levels advocated by local companies that protect their monopoly rates. Downward pressures on residential local rates are non-existent. Independent firms in markets that rely on the local distribution plant are willing to enter these arrangements because they are better off becoming the favored supplier in a joint venture, rather than compete, because the relationship with the incumbent conveys such a large advantage.

The bottom line impact on consumers of these entrenched monopolies is prices that are vastly inflated over competitive levels. Rather than enjoying the price reductions that consumers were promised, there have been significant upward pressures on rates, under the rubric of "rate rebalancing." Regulators have also found it convenient to shift costs onto residential ratepayers by adding surcharges to the bottom of the bill.